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January 5, 1981

INTERAGENCY
Mr. Clark R. Dierks
State Treasurer
Chairman, State Board of Deposit
State Capitol
1700 West Washington Ave.
Phoenix, Arizona 85007

Re: I81-016 (R80-097)

Dear Mr. Dierks:

This letter is in response to your letter dated April 29, 1980 wherein you posed the following questions: (1) whether under the provisions of the newly enacted Arizona Handling of Public Funds Act (the "Act"), A.R.S. § 35-301, et seq. the State Treasurer can accept bids on deposits of State monies from insured credit unions; (2) whether the State Treasurer can deposit State monies to an insured credit union which has lodged a successful bid without first becoming a member of the credit union; and (3) the specific credit union assets which qualify as capital for the purpose of determining the amount of deposits of State monies permitted under A.R.S. § 35-323.G. In answer to the first question, the State Treasurer is required under A.R.S. § 35-323.A to offer the opportunity to insured credit unions to bid upon deposits of State monies. With respect to the second inquiry, a deposit of State monies does not require that the State Treasurer first become a credit union member. As to the specific assets to be considered as capital in making the computation required under A.R.S. § 35-323.C, only undivided earnings and the reserve to a contingency may be considered.

Prior to answering the questions which you have posed, it is necessary to touch upon the objectives which were being sought by the Legislature in enacting the Act. It is a fundamental rule of statutory construction that when interpreting an act or provision contained therein that the intent of the Legislature be ascertained and that the act be construed, whenever possible, to effect such legislative intent. See A.R.S. § 1-211.A; Arizona State Board of Accounting v. Keebler, 115 Ariz. 239, 564 P.2d 928 (1977); and U.S. Fidelity & Guaranty Co. v. Michigan Bank, 27 Ariz. App. 478, 556 P.2d 326 (1976).

The enabling provision of the Act, Ch.108, 1980 Laws of Arizona (Second Reg. Session 1980), clearly establishes three legislative objectives:

> In this act, it is the intent of the legislature to secure the maximum public benefit from the deposit and investment of public funds. This policy is applicable to anyone entrusted with public monies.
>
> Treasurers and other public officials responsible for the investment of public funds should be allowed maximum discretion within the established guidelines, emphasizing safety of principal, liquidity and financial return on principal, in that order.
>
> All other factors being equal, preference should be given to the investment of funds with or through financial institutions and securities dealers with offices within Arizona. [Emphasis added]

The first and most important goal being sought is that of minimization of the risk to which state monies are exposed when deposited with eligible depositories or when purchasing market securities. Additionally, the investment must have liquidity. Thirdly, in the framework of these safety and liquidity concepts, maximization of financial return on any investment of state monies is sought. In answering your questions, an interpretation of the Act must seek accomplishment of these three principal legislative objectives.

With respect to your first question, under the prior law pertaining to deposits of State monies, receipt of state monies on deposit was limited to a commercial or savings bank insured by the Federal Deposit Insurance Corporation, or a savings and loan association insured by the Federal Savings & Loan Insurance Corporation. See A.R.S. § 35-325.01. However, Article 2 of the Act has been amended to provide that credit unions, federal and state, insured by the National Credit Union Administration, would be eligible to bid for and receive deposits of state monies. A.R.S. § 35-323.G now provides:

> G. Any commercial or savings bank or savings and loan association with its principal place of business in this state which is insured by the Federal Deposit, Insurance Corporation or Federal Savings and Loan Insurance

Corporation, or any successor, or any other insuring instrumentality of the United States, in accordance with the applicable law of the United States or a credit union which is insured by the national credit union administration, is eligible to become a public depository, subject to this article, and shall be referred to in this article as an "eligible depository." (Emphasis added.)

Pursuant to A.R.S. § 35-323.A, the State Treasurer is not only authorized but is required to provide not only commercial and savings banks and savings and loan associations but insured credit unions an equal opportunity to bid competitively on state monies available for investment. A.R.S. § 35-323.A.1, 2, and 3 states:

§ 35-323. Investment of public monies; bids; eligible depositories; surety bonds and collateral; restrictions

A. A treasurer may invest and reinvest public monies in securities and deposits with a maximum maturity of thirteen months in such proportions as provided in this section. A treasurer shall offer eligible Arizona depositories the opportunity to bid competitively on available investment funds before market securities are purchased. Eligible investments are:

1. Certificates of deposit in eligible depositories.

2. Interest bearing savings accounts in banks and savings and loan institutions doing business in this state whose accounts are insured by federal deposit insurance for their industry, but only if deposits in excess of the insured amount are secured by the eligible depository to the same extent and in the same manner as required under this article.

3. Repurchase agreements with maximum maturity of thirty days.

As readily apparent, since insured credit unions are now eligible depositories, the State Treasurer must provide them the same opportunity to bid on state monies as commercial or savings banks and savings and loan associations. Of course, as noted in 32-323.A.1 and 3, investments with eligible credit unions are limited to certificates of deposit and repurchase agreements.

The next question to be resolved is whether the State Treasurer, prior to actual deposit of state monies, must first become a member of the insured credit union. We think that membership in the insured credit union by the State Treasurer is unnecessary. In discussing this issue, insured federally chartered credit unions and state chartered credit unions will be discussed separately.

The Federal Credit Union Act specifically provides that federally chartered credit unions may receive payments on shares from nonmember units of state, local governments or political subdivisions thereof. Pursuant to 12 U.S.C. 1757.6, federal credit unions are authorized:

> (6) to receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, Indian tribal, State, or local governments and political subdivisions thereof enumerated in section 1787 of this title and in the manner so prescribed, from the Central Liquidity Facility, and from nonmembers in the case of credit unions serving predominately low-income members (as defined by the Board) payments on -
>
> (A) shares which may be issued at varying dividend rates;
> (B) share certificates which may be issued at varying dividend rates and maturities; and
> (C) share draft accounts authorized under section 1785(f) of this title;

See also 12 U.S.C. 1789.a which states:

> Any credit union the accounts of which are insured under this title shall be a depositary of public money and may be

> employed as fiscal agent of the United States. The Secretary of the Treasury is authorized to deposit public money in any such insured credit union. . . .

Based upon 12 U.S.C. 1757.6 and 12 U.S.C. 1789.a, membership in a federal credit union is clearly not required.

The Arizona Credit Union Act, A.R.S. § 6-501 et seq., does not expressly authorize the acceptance by state chartered credit unions of deposits from the nonmember units such as the State Treasurer. However, in enacting A.R.S. § 35-323.G, the Arizona Legislature may be deemed to have impliedly amended the Arizona Credit Union Act to permit state chartered credit unions to accept deposits of state monies. See State v. Morris, 7 Ariz.App. 326, 439 P.2d 298 (1968).

Under existing applicable provisions of the Arizona Credit Union Act, State Treasurer membership in state-chartered credit unions is a virtual impossibility. Pursuant to A.R.S. § 6-501.3, a state chartered credit union is a financial institution designated by the Legislature to provide its services to a special class of individuals sharing a common bond of interest.

> 3. A "credit union" is a cooperative nonprofit society, association or group organized and incorporated in accordance with the provisions of this chapter, for the purposes of creating thrift and self-reliance among its members and to make credit available to people of small means, through a system of cooperative lending at a reasonable and legitimate rate of interest in order to improve their economic and social condition. (Emphasis added.)

Pursuant to A.R.S. §§ 6-502.C and 6-506, the requirement of a common bond of interest is made a condition of membership.

> C. The field of membership in which the credit union proposes to operate shall provide a common bond of interest and a potential membership sufficient to assure the success of the credit union.

§ 6-506. Membership.

> Credit union membership of the subscribers to the application for organization who shall have paid for one or more full shares each, and such other suscribers within the field of membership as may be approved for membership by the board of directors and who shall have paid for one or more full shares. (Emphasis added.)

As hardly need be stated, the State Treasurer could not be within the field of membership of each and every state chartered credit union. To require membership by the State Treasurer would be to require an impossible act. Inasmuch as the Legislature is presumed not to engage in futile or impossible gestures, see City of Mesa v. Killingsworth, 96 Ariz. 290, 394 P.2d 410 (1965), we think application for membership to a state chartered credit union is not necessary.

Despite lack of membership, it is our position that deposits by the State Treasurer with insured state credit unions is permitted. We recognize that the express terms of the Arizona Credit Union Act, specifically A.R.S. § 6-509, provide that a state chartered credit union may receive deposits for payment of shares solely from its members:

§ 6-509. Powers of credit unions

> A credit union may:
> 1. Receive the funds of its members as payment on shares.
> 2. Receive the funds of its members, employers of members, sponsors or profit or pension trusts of such members, employers or sponsors in special investment accounts.

However, as noted before, the Legislature is presumed not to engage in futile acts by enacting a statute, or provisions thereof, which are not operative. See City of Mesa, supra. In light of this presumption, whenever possible, each clause of an act must be given such effect that it is not rendered superfluous, void, contradictory or insignificant. See State v. Superior Court for Maricopa County, 550 P.2d 626 (1976); Adams v. Bolin, 74 Ariz. 269, 47 P.2d 517 (1949); Powers v. Isley, 66 Ariz. 94, 183 P.2d 880 (1947); and Kelly v. Bastedo, 70 Ariz. 371, 220 P.2d 1069 (1950).

Imposing a requirement on the State Treasurer to extend the opportunity to bid for deposit of state monies under A.R.S. § 35-323, while at the same time prohibiting under § 6-509 a state chartered credit union which lodged a successful bid from accepting a deposit of state monies, would unquestionably constitute the enacting of a void, absurd or inoperative clause. As previously indicated in City of Mesa, supra, such inoperative legislation is to be avoided wherever possible.

This result may be avoided through application of a rule of statutory construction known as the doctrine of "implied amendment." This doctrine states it is proper to imply an amendment to an act where the intent of the Legislature is clear from a reading of two statutes and where they are so inconsistent that the intent cannot be fulfilled absent an amendment to one of the statutes. See State v. Morris, supra.

By enacting A.R.S. § 35-323.A and .G the Legislature sought to establish a new class of eligible depositories, insured credit unions, which would be authorized to bid upon, and if the highest bidder, to receive deposits of state monies. The addition of this new class of eligible depositories served the legislative objective of maximization of financial return on deposits of state monies. By increasing the number and classes of eligible depositories, the Legislature might reasonably anticipate higher rates of return on its deposits as a direct by-product of increased bidding competition. However, a state chartered credit union would not bid upon deposits of state monies if they would be unable to receive those deposits even if successful. It is apparent that the legislative intent expressed by A.R.S. § 32-353.A and .G will be frustrated if an amendment of the powers granted a credit union is not implied.

Based upon these inconsistencies, it is our position that upon enactment of A.R.S. § 35-323.G, the Arizona Legislature impliedly amended A.R.S. § 6-509 so that state-chartered credit unions are authorized to receive state monies obtained as a result of a bid entered pursuant to those terms set forth in the Act without the State Treasurer becoming a member.

Your final question focuses upon the types of credit union assets which may be considered in computing the "total capital structure." Specifically, your question concerns whether "paid in and unimpaired capital" as defined in A.R.S. § 6-501.11 may be included in the computation of the credit

union's total aggregate capital structure. It is our conclusion that, based upon a consideration of the purposes underlying the Act as well as applicable principals of statutory construction, it would be improper to employ the A.R.S. § 6-501.11 definition of "paid in and unimpaired capital" when determining which assets to include in the computation of total aggregate capital structure.

Pursuant to A.R.S. § 35-323.C, the Legislature has limited the total amount of deposits of state monies which may be received by an eligible depository:

> C. An eligible depository is not eligible to receive total aggregate deposits from this state and all its subdivisions in an amount exceeding twice its capital structure as outlined in the last call of condition of the superintendent of banks. (Emphasis added.)

This provision is an attempt to attain the fundamental overriding objective of the Act of minimizing the risk associated with the deposit of state monies in an eligible depository.

This provision recognizes that capital, both equity and debt, is a cushion for creditors and depositors in case the corporation suffers losses. Its withdrawal or retirement is subject to numerous statutes and Rules and Regulations. In this regard, review of pertinent provisions of the Arizona Corporation Code, the Arizona Banking Code and the Arizona Savings and Loan Code provides valuable insight as to the manner in which the total capital structure provides a cushion minimizing the risk to which state deposits are exposed and the reasons for not permitting employment of credit union shares and special investment accounts in computing an insured credit union's capital structure.

Under all three Codes, two basic classes of capital exist each with limitations restricting its dissipation and its withdrawal. The two classes are equity and debt capital. With respect to banks, equity capital is comprised of three separate tiers which can be arranged in order as to the degree of protection each tier receives. The most carefully protected element of equity capital is "stated capital," defined in A.R.S. § 10-002.18 and § 6-351.6 as the sum of:

1) the par value of all shares issued by the corporation;

2) the total amount received by a corporation for stock issued without a par value, less any amount allocated to "capital surplus,"; and

3) any other amounts which may be transferred to stated capital by the Board of Directors, including for instance, the value of a stock dividend to shareholders.

The next two tiers of equity capital are "surplus," as defined in A.R.S. § 10-002.20 and § 6-351.7. In order of protection from impairment, these two tiers are first "capital surplus," and second "earned surplus." "Capital surplus" is defined in A.R.S. § 10-002.6 and § 6-351.2 as that portion of surplus which is not earned surplus. To paraphrase the definition of "earned surplus" found in A.R.S. § 10-002.9 and § 6-351.3, it is the net profits or losses of the corporation, less any amounts distributed to shareholders as dividends and less any amount allocated to stated capital or capital surplus.

Debt capital is simply an approved unsecured indebtedness of the bank subordinated to the claims of all other creditors and depositors. See A.R.S. § 6-189 and § 6-408.01. The protection provided by equity and debt capital of a bank to the state monies arise from the restrictions placed upon withdrawal and retirement. The bank's capital structure as shown on the Superintendent's call of condition shows these types of capital as:

1) EQUITY CAPITAL:

   a) Stated capital
      Surplus stock
      Common stock

   b) Surplus (capital)
   c) Undivided profits (undivided earnings)

2) DEBTS CAPITAL

   a) Subordinated notes and debentures.

First, a dividend may not be declared at all if a corporation is insolvent (unable to pay its debts as they become due in the ordinary course of business) or if payment would render the corporation insolvent. If a corporation is

solvent a dividend may then be paid only out of unreserved and unrestricted earned surplus, or out of the net earnings of the current and the next preceding year ("nimble dividends"). A.R.S. § 10-045 and A.R.S. § 6-187.

With respect to capital surplus, further restrictions are imposed. Only in very limited circumstances can directors distribute assets to shareholders out of capital surplus. A.R.S. § 10-046 provides that distributions from capital surplus can be made only when: 1) the corporation is solvent and will not be rendered insolvent by the distribution; 2) distribution is provided for in the articles of incorporation or voted for by a majority of all shareholders (including holders of non-voting preferred stock); 3) all dividends on cumulative preferred stock have been paid in full; and 4) distributions from capital surplus will not bring net assets down to a level below any amount payable to preferred stockholders in the event of any involuntary dissolution. Although the requirements of A.R.S. § 10-046 are fairly stringent it is still possible for a corporation to comply and then significantly reduce capital surplus to the ultimate detriment of creditors. For this reason state banks are subject to even greater control. A.R.S. § 6-187 provides that "dividends payable other than in the bank's own stock may be paid out of "capital surplus," as defined in section 6-351 only with the approval of the superintendent." The reasons that stock dividends are exempted from this statute is that they involve a correspondent increase of stated capital and no decrease in a corporation's assets. A.R.S. § 6-351 defines capital surplus exactly the same as A.R.S. § 10-002.

Additionally, a corporation may, pursuant to A.R.S. § 10-069, reduce its "stated capital" according to carefully outlined procedures culminating with majority approval by the voting stockholders and public disclosure through the Corporation Commission. However, the surplus created by a reduction of stated capital becomes part of capital surplus and cannot be distributed to shareholders without compliance with A.R.S. § 10-046 and approval by the Superintendent of Banks pursuant to § 6-187. Therefore, any distribution of a bank's assets to shareholders out of stated capital or capital surplus is subject to the discretionary approval of the Superintendent of Banks.

Undivided profits being those remaining after dividends and operating expenses are paid, and losses obviously provides a source of protection for state deposits.

The controls upon retirement of bank capital notes (debt capital) are also extensive. First, prior to sale of capital notes, approval by the Superintendent must be sought based upon such conditions as he prescribes. The capital notes must be subordinated to the claims of the State Treasurer. Addition- ally, retirement of the capital must be approved by the Federal Deposit and Insurance Corporation. See 12 U.S.C. 1828.i.1. Savings deposits are not considered a capital as set by the Superintendent since withdrawal is subject only to the depositor's desires.

With respect to savings and loan associations, similar types of protections are also present. As noted in the Superintendent's call of condition, the savings and loan associations capital structure includes capital notes and debentures, guaranty capital stock, paid in surplus, earned surplus and undivided profits. The limitations on sale of capital notes are the same as those of a bank. See A.R.S. § 6-405.01. Retirement is subject to regulation by the Federal Savings and Loan Association. See 12 U.S.C. 1464.b.2. Withdrawal of guaranty capital shares is also strictly regulated and can only be accomplished under specified procedures. See A.R.S. §§ 6-424 and 6-428. Declaration of Dividends is controlled by the provisions of A.R.S. § 6-442. Again, simple savings accounts in the savings and loan association is not considered a capital asset since these deposits are fully withdrawable. See A.R.S. § 6-435.

As this analysis makes clear, the numerous restrictions placed upon the withdrawal of capital assets of state banks and savings and loans provide substantial protection against dissipation of corporate capital assets. These restrictions serve to insure that in case of economic difficulties the capital structure will remain intact and a source of income will exist from which return of state deposits may be sought. This system accomplishes in great part the legislative objective of minimizing risk.

This same objective would be defeated if with insured credit unions, the definition contained in A.R.S. § 6-501.11 is employed to compute the credit union's capital structure. Under A.R.S. § 6-517 a credit union's capital has been defined as including member's share account, special investment accounts and undivided earnings. See also A.R.S. § 6-501.11 which states:

> 11. "Paid-in and unimpaired capital" means, as of a given date, the balance of the paid-in shares and special investment accounts as of such date, less any losses that may have been incurred for which there is no reserve or which have not been charged against undivided earnings.

Contrary to the numerous regulations and statutes controlling withdrawal or retirement of banks and savings and loan association capital assets, the only limitations imposed upon withdrawal of shares and special investment accounts is that: (1) the credit unions bylaws may require 60 days advance notice; and (2) if a member has received or been a co-maker of a loan, a lien may be imposed. See A.R.S. §§ 6-507 and 6-517.2 The readily withdrawable nature of share and special investments accounts makes them similar to savings deposits and savings and loan savings accounts. As previously stated, such bank and savings and loan assets are not and should not be considered part of the financial institution's capital structure in the Superintendent's call of condition.

It would be absurd to hold that the Legislature in seeking to minimize risk would not permit consideration of bank savings deposits and savings and loan savings accounts while at the same time permitting essentially similar types of assets to be used in computing the credit union's capital structure. The presumption is that the Legislature does not engage in absurd acts. See State v Matty, 121 Ariz. 333 (1979) and State v. Valenzuela, 115 Ariz. 61, 567 P.2d 1190 (1977).

Interpretation of a statute requires the giving of a sensible construction which will accomplish the legislative intent and purpose. State v. Schroeder, 121 Ariz. 528, 591 P.2d 1305 (1979); and Employment Sec. Commission of Ariz. v. Fish, 92 Ariz. 140, 375 P.2d 20 (1962).

The assets of the credit unions, state and federal, which may be employed in making the statutorily required capital structure computation are undivided earnings and those funds maintained in the reserves for contingencies. With respect to undivided earnings, we have already touched upon this issue and will not repeat that discussion here. It merely should be noted that as reflected in the December 31, 1979, consolidated annual report of the 67 state chartered credit unions compiled by the Arizona State Banking Department and submitted to the Governor, the undivided earnings of all state chartered credit unions would be approximately $915,875.

With respect to the reserve for contingency for credit unions, we are of the opinion that such a reserve should be included in the capital structure computation. Pursuant to A.R.S. § 6-521.D, the Board of Directors of the state chartered credit unions has been empowered to establish such other reserves it deems necessary for the purpose of protecting the interests of its members. Acting under this authority, the Board of Directors of 46 and of the 67 state chartered credit unions during the year of 1979 did in fact establish a reserve for contingencies for their credit unions. The Board of Directors under the authority set forth in A.R.S. § 6-521 did in fact fund these reserves for contingencies with funds made up entirely of those obtained from undivided earnings. In this regard, it is noted that as stated in December 31, 1979, consolidated report, the total dollar amount of the reserve for contingencies for all state chartered credit unions was $2,439,306. Different than the reserves for loan losses and loan delinquencies established in A.R.S. § 6-521.A, B and C, and Rule R4-4-402, rules and regulations of the State Banking Department, the funds maintained in the reserve for contingencies is not earmarked for loan losses or loan delinquencies. In effect, the funds placed in the reserve for contingencies is nothing more than undivided earnings and as such can be considered part of the capital structure under A.R.S. § 35-323.C.

To permit any assets other than undivided earnings and reserve for contingency to be included in the capital structure computation would be absurd and would thwart the principal objective of minimization of risk.

In summary;

(1) The State Treasurer must extend the opportunity to bid on monies to insured credit unions;

(2) The State Treasurer need not be a member of the insured credit union to deposit state monies therein;

(3) The insured state chartered credit union under the doctrine of implied amendment may accept payments from the nonmember State Treasurer without violating A.R.S. § 6-509; and

(4) Only undivided earnings may be employed in computing a credit union's capital structure for purposes of complying with A.R.S. § 35-323.C.

We note, however, that the statutory framework is less than clear, particularly with respect to the capital structure requirement. Because the undivided earnings of a credit union are minimal, any investment by you would of necessity be negligible. Legislative clarification of the statutes should be sought.

Sincerely,

Bob Corbin

BOB CORBIN
Attorney General

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